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In the Supreme Court of the United States

October Term, 1973

CASE NO. 73-303

In The Matter Of

HALLMARK MEDICAL SERVICES, INC., ET AL.,
Debtors

WILLIAM H. MARTIN, Trustee,
Petitioner,

vs.

ISAAC MIZRAHI, STEPHEN CRAIR and HEIMAN AND CRARY, P.A.,
Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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COUNTER-STATEMENT OF THE CASE

The Respondents, ISAAC MIZRAHI, HEIMAN AND CRARY, P.A. and STEPHEN CRAIR were all objecting creditors to the Trustee's Amended Application to Classify Creditors and Determine Solvency (A. 16) and will be referred to as "Creditors", herein.

The Petitioner, WILLIAM H. MARTIN, was the duly appointed Trustee (A. 6) of the debtor, who submitted a Plan of Reorganization (A. 94) based upon the Classification of Creditors set forth in the Amended Application to Classify above. The Petitioner will be referred to as "Trustee", herein.

On or about August 7, 1970, a Creditor's Petition for Reorganization of a Corporation under Chapter X of the Federal Bankruptcy Act was filed against Hallmark Medical Services, Inc. Prior to and at the time of filing of this Petition, Hallmark was engaged in the business of building, operating and managing nursing homes and hospitals. (A. 1, 134). To be exact, Hallmark was operating six nursing homes located throughout Florida, and was caring for 472 patients (A. 227-230). In addition, Hallmark is the owner of a fully equipped hospital located in Largo, Florida (A. 135), as well as several other nursing homes under construction (70% complete) with a projected patient capacity of 620 beds when completed (A. 134).

The majority of Hallmark's patients are supported by either the State of Florida under the Family Services division of the Department of Health, Medicare program (A. 171-172) or the Federal Health Insurance for the Aged, Medicare program and Veterans Administration (A. 21-22, 227-230). Seventy-five percent of the patients

in the home are termed "medicaid skilled", which means they require more nursing care than most any other patient (A. 184, 229). All of these patients are supported by the State of Florida (A. 184).

The homes are required by the State of Florida to meet minimum care requirements for all patients and must have on duty at all time a specified number of registered nurses, licensed practical nurses and aides per patient (A. 185). In order to operate the nursing homes it is necessary to have professional, legal and top management personnel (A. 244-245).

A "good faith" hearing pursuant to Section 17 of the Bankruptcy Act, was held and on October 27, 1970, the Referee entered his Findings of Fact, Conclusions of Law and Recommendation on Order of Special Reference (A. 133). He found that the ownership of the stock in Hallmark had been sold, to a "new group headed by Isaac Mizrahi, who is acting as chief executive", after the Chapter X had been filed (A. 134); that the corporation was heavily in debt, the majority of which was secured (A. 135); that there were 364 occupied beds in five nursing homes (A. 134); that construction of an additional 620 beds were seventy-five percent complete (A. 134); that Hallmark owned a fully equipped hospital (A. 135). In determining that the Reorganization had been filed in "good faith", the Referee made the following Conclusions of Law: that the debtor was a functioning business with a significant going concern value, operating on a profitable basis; (A. 140, 142); the business of the debtor filled a "genuine need" (A. 140).

A hearing was held before the Referee as Special Master on October 28, 1971, at which hearing oral objec-

tions to the Trustee's classifications were made by the creditors and considered by the Special Master, including the contention that creditors furnishing credit (money or service) within six months prior to the appointment of a Trustee may be entitled to be treated as priority creditors and classed as an expense of administration. It must be noted that at this time no evidence was offered—indeed, no question of fact presented—as to what money or services were rendered to Hallmark by creditors herein since the Special Master held as a matter of law that the six-month's rule could not apply in this case.

On or about March 2, 1972, the Recommendations of Special Master re Classification of Creditors were filed (A. 20). In determining that no six month priority should be created, the Special Master concluded that the "six-month's rule" should not be applied to the reorganization of any private corporation; that the rule should only be applied to public or quasi-public corporations of the type known as public service corporations; that Hallmark (construction and operation of nursing homes and hospital) could not be considered that type of corporation or business (A. 20-23). The Referee further concluded that the equitable considerations were not present that might in some cases justify the creation of a class of priority creditors (A. 22). This determination was made, as pointed out above, without having heard any testimony or considered any evidence as to what money or services were supplied by the creditors, their purpose, and what effect was had on Hallmark. Accordingly, the Referee ruled that the objection based on the "six months rule" be overruled, (A. 23) and, thereafter filed an Amended Application to Classify Creditors without a provision for the "six-month" creditors (A. 16). Upon the Special Master's

recommendation, the United States District Court below affirmed the findings and conclusions of the Trustee's classification, and entered its order on March 15, 1972, (A. 28).

Creditors then appealed to the United States Court of Appeals for the Fifth Circuit which reversed the Referee and District Court as to the application of the six-month rule and remanded the case for further findings of law and fact. It is from this order of the Fifth Circuit, entered March 15, 1973, that this appeal is taken.

COUNTER-STATEMENT OF QUESTIONS PRESENTED

Whether this Court should grant certiorari where the court below correctly concluded that the "Six-Month's Priority Rule" in reorganizations under Chapter X of the Bankruptcy Act applies to corporations performing "quasi-public" functions, especially where the decision below merely remands this case to the District Court for a determination of whether certain creditors are entitled to the benefit of the rule.

REASONS FOR DENYING THE WRIT

POINT ONE

THE DECISION BELOW CORRECTLY HELD THAT A SIX MONTHS PRIORITY CLASSIFICATION OF CREDITORS MAY EXIST IN A REORGANIZATION OF A PRIVATE CORPORATION PERFORMING A QUASI-PUBLIC FUNCTION UNDER CHAPTER X OF THE BANKRUPTCY ACT.

Petitioner herein insists that the Court of Appeals for the Fifth Circuit has established a steadfast mandate

that as a matter of law all creditors of private corporations performing quasi-public functions are entitled to the benefit of the six months priority rule. This contention, however, blatantly distorts the actual import of the Fifth Circuit's opinion which can best be demonstrated by quotation from the opinion itself (See Petition, at A. 2 and A. 9):

> "We hold that the six months rule *may* apply to Chapter X reorganizations of quasi-public corporations. We remand for a determination whether under principles of equity, these creditors qualify for priority classification under that rule." (Emphasis ours.)

> "Having concluded that a six months class *may* exist for quasi-public corporations we remand the case for further proceedings to enable the district court to determine whether these appellants merit inclusion within the rule. We do not express any opinion whether equity weighs in favor or against these appellants or whether they should be properly classified as six months creditors." (Emphasis ours.)

What is clearly evident from these quotations is that the Fifth Circuit did not require the inclusion of the six-month priority rule, as Petitioner argues. It merely recognized that in a Chapter X reorganization, courts have full *discretion* to classify creditors and to determine priorities under the equitable powers granted by Sections 115 and 197 of the Bankruptcy Act, a discretion which was not exercised by the District Court when it held that *as a matter of law* the six months priority rule has no applicability to private corporations, notwithstanding the public function or service provided by them.

POINT TWO

THE DECISION BELOW CORRECTLY APPLIED THE SIX MONTHS PRIORITY RULE TO THE PARTICULAR FACTS OF AND CIRCUMSTANCES SURROUNDING THE REORGANIZATION OF HALLMARK MEDICAL SERVICES, INC., UNDER CHAPTER X OF THE BANKRUPTCY ACT IN FURTHERANCE OF THE PRINCIPLES UNDERLYING THE RULE.

First created and applied in railroad reorganizations, *Fosdick v. Schall*, 99 U.S. 235, 25 L.Ed. 339 (1878), the "Six-Months Priority Rule" was later extended to other public and quasi-public corporations and eventually applied to private corporations under Chapter X of the Bankruptcy Act. 11 *Remington, Bankruptcy*, Section 4535 (Rev. Ed. 1961); 6 *Collier on Bankruptcy*, Section 9.13(5) (14th ed.);

The leading case applying the "Six Months Rule" to a purely private corporation in a Chapter X reorganization is *Dudley v. Mealey*, 147 F.2d 268 (2 Cir. 1945). Judge Learned Hand, speaking for the Court in this landmark decision, stated:

> "... Just as it is recognized that, after insolvency, the expenses of continued operation of a business may be necessary to preserve its value for the secured creditors themselves, and for that reason that the receiver's creditors have priority, so it may be before insolvency. To take the case at bar,

> upon the continued operation of a hotel its good will depends; let it once shut down, with whom it must deal can be protected, as its credit slowly wanes before insolvency, it must begin to trade upon a cash basis, which may be difficult or even impossible. Some priority to them may be essential to the preservation of the business during that period as it is later. While the interests of the public were no doubt the paramount consideration of the origin of the rule, the interests of the lienors themselves may make equally imperative some protection to supply creditors." (Id, at 271).

And in *Johnson Fare Box Co. v. Doyle*, 250 F.2d 656 (2 Cir. 1958), the Second Circuit restated this equitable rationale:

> "(In) summary, the rule assumes that the debts contracted during a short period, usually fixed at six months before a receivership, for labor supplies or repairs necessary for a company's operation so redound to the benefit of the lien-holders and other creditors that they should receive preferred treatment." (Id, at 657).

Moreover, the two leading treatise authorities in the field of bankruptcy espouse the same view. *Collier*, supra., Vol. 6, Section 9.13(5) and *Remington*, supra., Vol. 11, Section 4535. It is important to note that although *Dudley*, supra, 147 F.2d 268, was decided twenty-eight years ago, Congress has not seen fit to enact any legislation in any way modifying the rule announced there. The subsequent decisions have likewise announced that the applicability of the six months rule depends upon the facts and circum-

stances of the particular case. *In Re Pusey v. Jones Corp.*, 295 F.2d 479 (3 Cir. 1961); *In Re North Atlantic & Gulf S. S. Co. Inc.*, 200 F.Supp. 878 (S.D. N.Y. 1962).

What must be emphasized is that the Fifth Circuit did not broadly conclude that all nursing homes, let alone any other type of corporation, are "quasi-public." To the contrary, the lower Court held that "the *function*, not the characterization of the corporation" is a determining factor in deciding whether to apply the rule to certain corporations. (See Petition, at A. 4 and A. 7).

In the instant case, the continued operation of the nursing homes of Hallmark Medical Services, Inc. had a direct relation to public health. At the filing of the involuntary petition on August 7, 1970, Hallmark was providing services to 472 patients and was constructing facilities for an additional 620 patients. Seventy-five percent of these patients were classified as "Medicaid Skilled" which meant that they were seriously ill and required skilled nursing care. The revenue generated from medical attention afforded these "Medicaid Skilled" patients was in fact less than the cost of the services provided. Only 134 of the 472 patients in the Hallmark nursing homes were classified as "private," leaving a balance of 338 whose medical expenses were paid from various governmental sources including the Division of Family Services of the State of Florida (Medical Assistance for the Needy, Florida Statutes, Section 409.266), Medicare (Federal Health Insurance for the Aged, 42 U.S.C., Section 1395 et seq.), and Hospital, Domiciliary, and Medical Care for Veterans (38 U.S.C., Sections 610 et seq.). In addition, the homes were licensed and regulated by Florida statutes

prescribing minimum standards of operation, a violation of which may result in the imposition of criminal penalties. See Florida Statutes, Sections 400 et seq. If these nursing homes were closed, the 472 patients would be forced to find other accommodations. And since the area is underbuilt, private patients (who pay more) would be given the available space while medicare and medicaid recipients would be at a disadvantage.

Even the Special Master must have been convinced that there is a strong need for and great public interest in the continued operation of the nursing homes for he concluded that:

> " . . . the Central Florida market is underbuilt and there is a growing need for additional nursing homes." (A. 138).
>
> * * *
>
> " . . . the ever growing concern with health care could indicate a promising future for the industry." (A. 138).
>
> * * *
>
> "Its business fills a genuine need . . . " (A. 140).

So then, under the broad principles of equity, creditors who supply credit, labor or services necessary to keep a quasi-public corporation operating and thereby help to preserve the good will, the going concern value and the assets for the benefit of *all* creditors, should be given a priority status.

POINT THREE

THE DECISION BELOW CORRECTLY REMANDED THE CASE TO THE DISTRICT COURT FOR FURTHER FINDINGS OF FACT AND LAW ON THE CLASSIFICATION OF RESPONDENTS AS SIX MONTHS CREDITORS; THEREFORE, THE CASE IS NOT RIPE FOR DECISION HERE.

Having determined that the District Court erred, the Fifth Circuit properly remanded this case for a determination as to "whether equity weighs in favor or against (the Respondents) or whether they should properly be classified as six months creditors." (See Petition, at A. 9). What should be emphasized is that until testimony is presented and evidence offered on what services were rendered or money or credit extended to Hallmark by Respondents, the record of this case will be deficient. It is therefore imperative that a hearing first be held to review these matters and to determine whether such were necessary to the continued operation of Hallmark. If it be decided that Respondents herein do not merit inclusion within the six months rule, then the issues defined in this case become, and indeed are, moot.

Therefore, this Honorable Court should deny Petitioner's Writ of Certiorari until such time as the record is factually completed and all issues stemming from this case are ripe for this Court's review.

CONCLUSION

The opinion below merely applies traditional, well-settled principles of bankruptcy law to the facts before the Fifth Circuit, an application which is demonstrably correct. It represents no departure from the course charted by all of the Circuit Courts and presents no possibility of "recurrent obstacles to the achievement of successful corporate reorganizations." (Petition, p. 2). Of equal importance, the Fifth Circuit has remanded this case for a full factual development so that a record will be available for the exercise of appropriate equitable discretion which a federal court should exercise pursuant to *Sections 115 and 197* of the Bankruptcy Act. Any review by this Court of the proper application and scope of the six-month priority rule should wait until all questions of fact and law have been adjudicated in the courts below.

Respectfully submitted,

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CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing Brief in Opposition to Petition For Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit was served by mail upon William Knight Zewadski, Esq., Post Office Box 1102, Tampa, Florida 33601, and Leonard Gilbert, Esq., Post Office Box 3239, Tampa, Florida, 33601, Attorneys for Petitioners, this _____ day of September, 1973.

_____

Of Counsel